COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. NO.: 2326-01
BILL NO.: Perfected HB 1159
SUBJECT: Taxation and Revenue-Income-Retirement Systems and Benefits-General
TYPE: Original
DATE: May 2, 2000

FISCAL SUMMARY

ESTIMATED NET EFFECT ON STATE FUNDS			
FUND AFFECTED	FY 2001	FY 2002	FY 2003
General Revenue	($35,744,003)	($433,051,265) to ($530,751,265)	($556,446,086) to ($659,146,086)
Blind Pension	$0	$0	$0
Partial Estimated Net Effect on All State Funds*	**($35,744,003)**	**($433,051,265) to ($530,751,265)**	**($556,446,086) to ($659,146,086)**

***The unknown revenue losses are not reflected in the partial net effect to State Funds.**

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2001	FY 2002	FY 2003
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON LOCAL FUNDS			
FUND AFFECTED	FY 2001	FY 2002	FY 2003
Local Government	**$0**	**(Unknown)**	**(Unknown)**

Numbers within parentheses: ( ) indicate costs or losses.
This fiscal note contains 13 pages.

FISCAL ANALYSIS

ASSUMPTION

SECTION-135.010-EXCLUDES SOCIAL SECURITY, RAILROAD AND TEACHERS

Officials of the **Department of Revenue (DOR)** state this legislation excludes from the definition of household income when figuring the property tax credit any social security, railroad retirement or teachers retirement benefits.

The Department assumes there will be an increase in property tax credit returns and will need one Tax Processing Tech I for every 67,000 additional credits received.

Oversight assumes, for purposes of this fiscal note, that the number of additional property tax credit returns filed would be minimal and that the Department of Revenue could handle the provisions of this proposal with current resources.

University of Missouri Research Center states their estimate is based on 1998 income tax data. University staff estimates the loss to General Revenue to be $11 million in 2001.

SECTION-135.918-MISSOURI AGRICULTURAL INVESTMENT TAX CREDIT ACT

Officials of the **Department of Revenue (DOR)** state this portion of the proposal allows a 10% credit for any individual or corporate farmer up to $5,000 for any section 179 (depreciable and written off) property purchased. Credit may be carried back 3 years and forward 5 years.

This is a 10% credit up to $5000 for certain equipment that is expended under section 179 of the internal revenue code. It is a corporate tax credit as well as an individual credit. Both the COINS (corporate) system and the MINITS (individual) system will be impacted. The tax credit tracking system will also be impacted since the credit may be carried back 3 years and forward 5 years. Each system change will require 300 hours of programming (900 total). One Tax Processing Technician will also be required to administer this new credit. The State Data Center will charge $5,000 to test and implement these changes.

Officials of the **Department of Agriculture (AGR)** state this proposal would not fiscally impact their agency.

Oversight was unable to locate any empirical data in order to estimate the fiscal impact of this portion of the proposal. Therefore Oversight, for purposes of this fiscal note, has shown the fiscal impact of this portion of the proposal as an unknown loss to General Revenue.

ASSUMPTION (continued)

SECTION-137.115-FREEZE ON ASSESSED VALUATION

State Tax Commission (TAX) officials estimated possible loss of income. The 1990 census indicated that 25% of occupied housing units are occupied by persons 65 or older. Recent increases in assessments for residential properties have been 12% in reassessment years (or about $3,100,000,000 affecting FY 2002). Assuming over-64's account for 25% of the increase and an average tax rate of $5.87 per $100 assessed valuation, the possible loss computes to about $52,000,000 for FY 2003. The Blind Pension Fund Tax, which is $.03 per $100 assessed valuation, reimbursement would be about $265,000 in FY 2003.

TAX officials would also request one audit clerk to receive and analyze requests for payments from approximately 2,500 political subdivisions and certify for payment by Office of Administration.

TAX officials and the Cole County Assessor noted that assessors would have to maintain two sets of assessments for exempt parcels. It is not possible to estimate how much those costs would be until assessors could determine how many parcels would be affected; therefore, unknown additional costs to county assessors are reflected in the fiscal impact to local governments.

Department of Elementary and Secondary Education officials note that the proposal would decrease tax collections, which would increase the amount needed to fully fund the Foundation Formula. They also noted that 1) "on the formula" districts would recoup their losses through state payments, and 2) "hold harmless" districts would not recover losses through additional payments through the Foundation Formula.

Oversight assumes that:

1) the state will reimburse political subdivisions for their payments in lieu of Blind Pension taxes from the General Revenue Fund;

2) there will be sufficient general revenue funds to allow payments to political subdivisions in FY 2003;. (Oversight notes that there could be a savings to the General Revenue Fund since the circuit breaker property tax credit is a refund of property taxes paid by an individual. Since the proposal would limit the amount of property taxes paid, some circuit breaker payments would be less than under current law. It is unknown how many individuals would claim this property tax exemption, or how much payments would be reduced. Oversight assumes the effect would not be material.)

ASSUMPTION (continued)

SECTION-143.114-DEDUCTION FOR HEALTH INSURANCE PREMIUMS AND OUT-OF-POCKET MEDICAL COSTS

Officials of the **Department of Revenue (DOR)** state this legislation authorizes a deduction from Missouri adjusted gross income for documented health insurance premiums and out-of-pocket medical costs, to the extent such amount is included in the taxpayer's federal adjusted gross income and is not otherwise deducted. The amount of the credit is equal to the amount paid by the individual, not to exceed $2,000.

The number of taxpayers eligible for this deduction is unknown at this time. The Division of Taxation will need one temporary tax season employee (a cost of $6,067) for every 180,000 returns filed with this deduction and one tax season employee for every 3,000 pieces of correspondence generated from this credit. One Tax Processing Tech I will also be needed for every 30,000 income tax errors generated.

This legislation will require modifications to the individual income tax systems. The Division of Taxation estimates these modifications, including programming changes, will require 1,384 hours of contract labor at a cost of $41,617. Modifications to the income tax returns and schedules will be completed with existing resources. State Data Center charges will increase due to the additional storage and fields to be captured. Funding in the amount of $9,007 is requested for implementation costs and $1,673 for on-going costs.

Office of Administration (**COA**) officials stated this proposal would have both a health insurance deduction and an out-of-pocket medical expense deduction.

HEALTH INSURANCE DEDUCTION:

COA officials state that $4,205,036,928 in health insurance premiums were written in Missouri in FY 1998 per the Department of Insurance. COA states that according to Table 168 in the 1998 Statistical Abstract, 27.15% of health insurance premiums are paid by individuals. COA assumes that taxpayers would not adjust their withholdings in FY 2001 to take advantage of this credit. Based on data from Oversight it was assumed that 15% of all premiums paid by individuals are run through cafeteria plans and are not included in federal adjusted gross income. Therefore, the amount of premiums paid by individuals is lowered by 15%. COA assumes a 3% annual growth. COA estimates that revenue would be reduced by $0 in FY 2001, $65.5 million in FY 2002, and $67.5 million in FY 2003.

OUT-OF-POCKET MEDICAL EXPENSE DEDUCTION:

ASSUMPTION (continued)

COA states the out-of-pocket medical cost per capita from the Health Care Financing Administration's Health Care Expenditures Projections to be $822 in FY 2001 and $864 in FY 2002. COA states that based on Missouri individual income tax data the number of people per return for each type of return was calculated to arrive at a per capita figure. COA states this number was then multiplied by the per capita out-of-pocket medical cost to arrive at a state wide out-of-pocket expenditure. Based on data from Oversight it was assumed that 15% of all premiums paid by individuals are run through cafeteria plans and are not included in federal adjusted gross income. Therefore, the amount of premiums paid by individuals is lowered by 15%. COA assumes a six percent marginal tax rate. COA assumes the amount deducted would be ranged from fifty percent participation to one hundred percent participation. COA estimates that revenue would be reduced by $0 in FY 2001, $97.7 million to $195.4 million in FY 2002, and $102.7 million to $205.4 million in FY 2003. COA further states that after discussions with the Department of Revenue, it is assumed that this would not be an itemized deduction but a subtraction from adjusted gross income which could be taken by itemizers or non-itemizers.

COA states that in FY 2002, approximately 278,000 returns would be over the cap by approximately $724 for a total of $12.1 million. Therefore, the estimate is increased by this amount. In FY 2003 approximately 278,000 returns would be over the cap by approximately $849 for a total of $14.7 million. Therefore, the estimate is increased by this amount.

The out-of-pocket medical expense deduction projection was based on data provided by the Health Care Financing Administration. **Oversight** determined the projections for the out of pocket medical cost per capita increased from $802 to $864 for FY 2002.

SECTION-143.121-PENSION AND SOCIAL SECURITY BENEFITS

EXEMPTS ALL RETIREMENT BENEFITS

Officials of the **Department of Revenue (DOR)** state this portion of the proposal allows a subtraction for all retirement benefits to the extent they are included in the taxpayer's federal adjusted gross income.

The Division of Taxation will need one temporary tax season employee (a cost of $6,067) for every 260,000 returns filed with this subtraction and one Tax Processing Tech I for every 3,000 pieces of correspondence received regarding the subtraction. The Division of Taxation will also need one Tax Processing Tech I for every 30,000 errors generated by this legislation.

ASSUMPTION (continued)

This legislation will require modifications to the individual income tax system. The Division of Taxation estimates these modifications, including programming changes, will require 1,384 hours of overtime at a cost of $41,617. Modifications to the income tax returns and schedules will be completed with existing resources. State Data Center charges will increase due to the additional storage and fields to be captured. Funding in the amount of $9,007 is requested for implementation costs and $2,206 for on-going costs.

Officials of the **Office of Administration (COA)** state this portion of the proposal exempts all retirement benefits from Missouri individual income tax.

There is no income limit on this deduction. The Spring 1999 Statistics of Income reports total Missouri pension income as $4,784,006,000 in tax year 1997. Four-percent growth was assumed. From the total pension benefits the amount that can already be deducted under RSMo. Section 143.124 is subtracted. The amount to be subtracted for the government pension deduction is from the 1998 Tax Expenditure Report. The fiscal note for HB 491 shows that the amount subtracted for the private pension deduction should be $60.7 million in FY 2002 and $71.3 million in FY 2003. A 6% marginal tax rate was assumed. COA staff assumes that taxpayers will not adjust their withholdings in FY 2001 to take advantage of this exemption. The revenue reduction to General Revenue would be $0 in FY 2001, $244.6 million in FY 2002 and $246.2 million in FY 2003.

Oversight recalculated the pension benefits of $4,784,006,000 at the 5.2% effective tax rate rather than the 6% maximum tax rate and arrived at $148.4 million in FY 2002 and $202.7 million in FY 2003.

In the first year of the proposal it is assumed that approximately 70% of those eligible will utilize the exemption. In FY03 it is assumed 95% will utilize the exemption.

REMOVE SOCIAL SECURITY BENEFITS FROM AGI

Officials of the **Department of Revenue** (**DOR**) state the proposal would allow taxpayers to subtract from their federal adjusted gross income any social security benefits included in their federal gross income.

ADMINISTRATIVE IMPACT:
The IRS in its Spring 1999 Statistics of Income Bulletin reports that there are 166,486 federal returns filed by Missouri taxpayers reporting over $1.2 billion in social security benefits. The Division of Taxation does not anticipate a significant impact at this time from this legislation.

ASSUMPTION (continued)

However, the Division of Taxation would need one Tax Processing Technician I for six months (at a cost of $8,340) for every 30,000 additional errors generated, and one temporary tax season employee (at a cost of $6,055) would be needed for every 360,000 returns received with this subtraction. For every 3,000 additional pieces of correspondence generated by this legislation, one Tax Processing Technician I would be needed. FTE will not be requested at this time, however, if additional FTE are needed it will be requested through the normal budget process.

This legislation would require modifications to the income tax system. The Division of Taxation and Collections estimates these modifications, including programming changes, would require 822 hours of overtime at a cost of $20,808. Modifications to the income tax return and schedules would be completed with existing resources. State Data Center charges would increase due to the additional storage and fields to be captured. Funding of $5,630 would be requested.

Officials of the **Office of Administration** (**COA**) state the Spring 1999 Statistics of Income report that Social Security benefits in Missouri adjusted gross income for 1997 were $1,231,423,000. COA states this is the first year that Social Security benefits have been reported by state. COA also states that national Social Security benefits have been growing at about 18% annually since 1994. A 10% growth rate was used for this estimate. A 6% marginal tax rate was then used to determine the amount of individual income tax revenue lost to the state. COA assumes that taxpayers would not adjust their withholdings in FY 2001 to take advantage of this proposal, causing the revenue impact not to be felt until FY 2002.

Oversight estimates a loss to the General Revenue Fund of $24,590,909 for FY 2001 due to the possibility of reduced withholding and estimated income tax payments for five months of calendar year 2001. **Oversight** assumes 25% of Missouri taxpayers would adjust payments, however it should be noted that this amount could be less depending on taxpayers' awareness of the deductibility of Social Security benefits in determining state income tax and their desire to adjust withholdings or estimated payments.

SECTION-143.124-EARNED INCOME TAX CREDIT

Officials of the **Department of Revenue (DOR)** state according to the Federal Statistics of Income Bulletin, there were 393,452 Missouri taxpayers that received an earned income tax credit on their federal return in 1997. The Division of Taxation indicates this credit would have a 2.5% impact to the new income tax process. Therefore, one temporary tax season employee would be needed for five months (at a cost of $6,065) in order to process these credits, and two Tax Processing Tech I's would be needed in order to review and correct the errors generated by this legislation.

ASSUMPTION (continued)

Additional funding for postage would be needed in order to notify potentially eligible filers, as required in this legislation. The Division of Administration indicates the basic postage for an automated mailing is $.27 per notice. However, the number of taxpayers needing notification is unknown at this time.

This legislation would require modifications to the income tax system. The Division of Taxation estimates these modifications, including programming changes, would require 1,427 hours of programming and supervision at a cost of $27,144. Modifications to the income tax return and schedules would be completed with existing resources. The State Data Center charges would increase due to the additional storage and fields to be captured. Funding in the amount of $9,288 would be requested for implementation costs and $890 for ongoing costs per year.

According to officials at the **University of Missouri**, there was a total of $600.8 million in federal earned income tax credits filed with a Missouri address for 1998. Using the 2.5% proposed for a Missouri earned income tax credit, this would calculate to $15.02 million state impact.

For purposes of this fiscal note, **Oversight** has assumed that for FY 2002 90% of taxpayers who use the federal credit will use the state credit. For FY 2003 **Oversight** assumes that 95% of taxpayers who use the federal credit will use the state credit. **Oversight's** estimate is based on the amount of earned income tax credit claimed in Missouri for tax year 1998 according to the University of Missouri Research Center ($600,800,000). **Oversight** assumed an annual growth rate of 1.7%. **Oversight's** assumption is based on conversations with other states that currently have an earned income tax credit in place and the provision in this proposal that requires the Department of Revenue to notify potentially eligible filers.

This proposal would result in a decrease in Total State Revenues.

FISCAL IMPACT - State Government	FY 2001 (10 Mo.)	FY 2002	FY 2003
GENERAL REVENUE FUND			
Loss to General Revenue Fund			
Increase in Circuit Breaker tax credits	($11,000,000)	($11,000,000)	($11,000,000)
Loss - General Revenue Fund			
Agricultural Investment Tax Credit	(unknown)	(unknown)	(unknown)

FISCAL IMPACT - State Government	FY 2001 (10 Mo.)	FY 2002	FY 2003
Department of Revenue (DOR)			
Personal Service (1 FTE)	($16,810)	($20,676)	($21,193)
Fringe Benefits	($5,169)	($6,358)	($6,517)
Expense and Equipment	($32,000)	$0	$0
Administrative Cost to DOR	($53,979)	($27,034)	($27,710)
Cost - Reimbursements to Political Subdivisions	$0	$0	($52,265,000)
State Tax Commission (TAX)			
Personal Service (1 FTE)	$0	$0	($21,538)
Fringe Benefits	$0	$0	($6,623)
Expense and Equipment	$0	$0	($10,300)
Administrative Cost to TAX	$0	$0	($38,461)
Department of Elementary and Secondary Education			
Increase cost to fund Foundation Formula	$0	$0	(Unknown)
Loss to General Revenue Fund			
Deduction health insurance premiums	$0	($65,500,000)	($67,500,000)
Deduction for out-of-pocket medical expenses	$0	($85,600,000) to ($183,300,000)	($88,500,000) to ($191,200,000)
Loss to General Revenue Fund			
Pension Exemption	$0	($148,439,381)	($202,783,304)
Loss - General Revenue Fund			
Deduction of Social Security Benefits	($24,590,909)	($108,200,000)	($119,000,000)

FISCAL IMPACT - State Government	FY 2001 (10 Mo.)	FY 2002	FY 2003
Cost - Department of Revenue			
Reprogramming costs	($26,438)	$0	$0
Cost to General Revenue Fund			
Department of Revenue (DOR)			
Personal Service (2.5 FTE)	($50,955)	($48,813)	($50,032)
Fringe Benefits	($7,322)	($15,010)	($15,385)
Expense and Equipment	($14,400)	($1,823)	($1,878)
Total Cost-Department of Revenue	($72,677)	($65,646)	($67,295)
Loss to General Revenue Fund			
2.5% Earned income tax credit	$0	($14,219,204)	($15,264,316)
PARTIAL NET EFFECT ON GENERAL REVENUE FUND*	**($35,744,003)**	**($433,051,265) to ($530,751,265)**	**($556,446,086) to ($659,146,086)**
BLIND PENSION FUND			
Income - Payments In Lieu of Taxes	$0	$0	$265,000
Loss - Reduced Property Tax Collections	$0	$0	($265,000)
ESTIMATED NET EFFECT ON BLIND PENSION FUND	**$0**	**$0**	**$0**

FISCAL IMPACT - Local Government	FY 2001 (10 Mo.)	FY 2002	FY 2003
POLITICAL SUBDIVISIONS			
Income - Reimbursements from State	$0	$0	$52,265,000

FISCAL IMPACT - Local Government	FY 2001 (10 Mo.)	FY 2002	FY 2003
Costs - Reduced Property Tax Collections and Payments in Lieu of Blind Pension Fund Taxes	$0	$0	($52,265,000)
Cost - Assessor costs to keep two sets of books	$0	(Unknown)	(Unknown)
ESTIMATED NET EFFECT ON POLITICAL SUBDIVISIONS	**$0**	**(Unknown)**	**(Unknown)**

FISCAL IMPACT - Small Business

Small businesses could be impacted by this proposal to the extent that small farmers would seek and receive an agricultural investment tax credit.

DESCRIPTION

Under current law, the first $6,000 in pension income received by retired state and federal employees is exempt from taxation. A similar exemption for other retirees is being phased in and will be complete in 2002. This act exempts all retirement income from taxation.

This act authorizes, for all taxable years beginning on or after January 1, 2001, a state income tax credit equal to two and one-half percent of the amount which a taxpayer claims as a federal earned income tax credit. The credit is refundable to the extent that the credit exceeds the amount of tax due or may be carried forward to a subsequent taxable year. The Department of Revenue is required to notify potential claimants of their eligibility.

This bill allows an individual income tax deduction for insurance premiums and out-of-pocket medical costs paid by a taxpayer up to $2,000 per tax year. The deductible amount is only to the extent that the costs are included in a taxpayer's federal adjusted gross income. Out-of--pocket medical costs are those deductions allowed for health costs as a federal itemized deduction. The deduction will apply to tax year 2001 and ends after tax year 2005.

This bill expands the income qualifications for eligibility for the senior citizens/disabled persons property tax credit, commonly known as circuit breaker. Taxpayers will be allowed to deduct from eligible income 100% of any social security benefits, railroad retirement benefits, and

DESCRIPTION
(Continued)

public school retirement benefits received during the tax year. The bill will apply to tax year 2000 and thereafter.

This bill authorizes a homestead exemption for purposes of real property tax relief for persons who are at least sixty-five years of age and who own and reside on property which qualifies as a homestead.

The exemption would be for the part of the assessed value of the homestead which exceeds the assessed value of the homestead in the year in which the owner reaches sixty-five or on the effective date of the proposal, whichever is later.

Provisions are included to allow political subdivisions to recoup any loss in revenue as a result of the proposal, to protect income to the Blind Pension Fund and to allow a moratorium on the homestead exemption if the General Assembly determines that total state revenues are insufficient in any year.

This portion of the proposal has an effective date of January 1, 2002.

For the purpose of determining Missouri individual income tax liability, this bill allows as a subtraction from federal adjusted gross income any amount of Social Security benefits received to the extent the amount is included in federal adjusted gross income.

This deduction will be allowed beginning with tax year 2001.

This bill creates the Missouri Agricultural Investment Tax Credit Program.

Taxpayers who qualify as farmers under federal and state law will be allowed to take a 10% state income tax credit for the cost of any item which is allowed as an expensing item election under federal law. The maximum credit will be $5,000 per taxpayer per year. The credit is not refundable, but excess credits may be carried back 3 tax years or forward 5 tax years.

The credit will apply to tax years 2000 and thereafter.

This legislation is not federally mandated, would not duplicate any other program and would not require additional capital improvements or rental space.

SOURCES OF INFORMATION

Department of Revenue
University of Missouri Research Center
Department of Agriculture
State Tax Commission
Department of Elementary and Secondary Education
Office of Administration

Jeanne Jarrett, CPA
Director
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